STATE OF IOWA
PROPERTY ASSESSMENT APPEAL BOARD

HCP Eby 1 Davenport, LP, Appellant, **v.** **City of Davenport Board of Review,** Appellee.	**ORDER** **Docket No. 13-103-1003** **Parcel No. Y0823-01**

On June 4, 2014, the above-captioned appeal came on for hearing before the Iowa Property Assessment Appeal Board. The appeal was conducted under Iowa Code section 441.37A(2)(a-b) (2013) and Iowa Administrative Code rules 701-71.21(1) et al. Deborah A. Davis of Strategic Tax Services, Inc. represented HCP Eby 1 Davenport, LP. Attorney John E. Lande of Dickinson, Mackaman, Tyler & Hagen, P.C., Des Moines, Iowa, is counsel for the Board of Review. The Appeal Board now, having examined the entire record, heard the testimony and being fully advised, finds:

Findings of Fact

HCP Eby 1 Davenport, LP (Eby) is the owner of property located at 4040 East 55th Street, Davenport, Iowa. The real estate was classified commercial on the January 1, 2013, assessment and valued at $2,350,000, representing $523,200 in land value and $1,826,800 in improvement value. According to the record, the property operates as Bickford Cottage, an assisted living center. It is a one-story building with 23,317 square feet and was built in 1998. The facility has 42 units: 19 efficiencies and 23 one-bedroom apartments. It has typical supporting facilities, such as a commercial kitchen, dining areas, beauty salon, community rooms, laundry facilities, and offices. The 2.35-acre site has paved parking, yard lights, and fencing.

Eby claimed the assessment was not equitable compared to other like properties and that the property was assessed for more than the value authorized by law under Iowa Code sections 441.37(1)(a)(1) and (2). The Board of Review denied the claims.

Eby then appealed to this Board re-asserting its claims; however, the only evidence and testimony presented was regarding its claim of over-assessment. Therefore, this is the only claim we will address. It now asserts the correct value is $1,900,000.

Eby submitted several exhibits in support of its claim. These exhibits include a 2007 decision by this Board in *Independence Creek, L.P. v. Polk County Board of Review*, Docket No. 07-77-0309. (Exhibit 2). *Independence Creek* involved an independent living facility compared to the assisted living facility at issue here and we, therefore, find this case distinguishable.

Eby also provided an excerpt titled “The Case for Investing in Seniors Housing and Long Term Care Properties with Updated Projections” authored by Price Waterhouse Coopers (Exhibit 6) and an excerpt titled “Assessing Congregate Care Facilities: a Unique Problem in Valuation” authored by Daniel J. Wallery. (Exhibit 7). In addition, Eby provided selected pages of a master lease agreement that it is not for the subject property. (Exhibit 8). Although these exhibits may be instructive on valuation methodology, they do not provide a valuation for the subject property. As a result, we find them of limited relevance and instead focus our attention on the appraisals submitted into the evidence by the respective parties.

Eby submitted an appraisal by David Mark Nelson of Roy R. Fisher, Inc., Davenport, Iowa. Nelson did not develop the sales comparison approach asserting a lack of sales of assisted living facilities. His report indicates his belief that there are few sales of independent and assisted living facilities in the regional market available for comparison and it is difficult to obtain reliable confirmation of the various value components, i.e. real property, personal property, business value. (Exhibit 1, p. 12). He states that most sales of assisted living properties include significant amounts of personal property and business value and proper real estate allocations are rarely made. (Exhibit 1, p. 12).

Nelson developed the cost and income approaches, concluding a value opinion of $2,090,000 and $2,030,000 respectively. He gives both approaches consideration and concludes a final opinion of value of $2,050,000. However, this value represents a January 1, 2014, "stabilized occupancy." After establishing this 2014 stabilized value, he discounted it to estimate the January 1, 2013 market value of $1,900,000.

In the cost approach, Nelson did not establish his own opinion of land value, but instead relied on the assessed land value of $523,200. He provided no explanation as to whether he conducted any analysis to confirm this was a fair market value for the land. He used Marshall and Swift, a cost handbook, to determine a $102.86 per-square-foot value for the replacement costs new. He explains in his report that he supported the Marshall and Swift estimates through extraction of similar one-story assisted living centers built in the central Iowa market. (Exhibit 1, p. 10). In his cost analysis, however, he compares the kitchen and dining area of the subject property to a full service restaurant and asserts it is an over improvement for the facility. For this reason, he reduces the cost approach by roughly $70,000 for functional obsolescence of the kitchen and dining area. Nelson also states in his report that be believes the subject property is very similar and comparable to apartments. (Exhibit 1, p. 10). He reiterated this opinion throughout his testimony. Ultimately, we find his comparison of the subject property to apartments, or the kitchen/dining areas as being super-adequate, flawed. The subject property was specifically built for and currently used as an assisted living facility, and therefore, we do not agree with his comparison of the property to apartments.

Nelson included a list of sales, but did not develop a sales comparison approach. (Exhibit 1). He testified the sales he submitted "[d]iffer significantly from the physical components" of the subject property. He also used these sales to extract capitalization rates for the income approach and believes they provide a “test of reasonableness” when compared to his cost and income results. We question the use of self-described “not comparable” properties. We do not believe that properties deemed “not comparable” would provide a test of reasonableness for the value conclusions or provide reliable capitalization rates.

Further, in establishing a market rent for the subject units in his income approach, Nelson relied on an April 2013 Davenport/Bettendorf Apartment rental survey. (Exhibit 1, pp. 12-13). Based on this survey, Nelson chose a base rent of $1.08 as indicated by the Ashford Apartments. The Ashford Apartments that Nelson primarily relies on are one-bedroom, 566-square-foot apartments units. (Exhibit 1, p. 13). Conversely, the average unit of the subject property is 316 square feet. (Exhibit D, p. 47). Nelson notes he will make a 10% upward adjustment to account for age/condition differences, but he appears only to make a 5% adjustment (Exhibit 1, pp. 13, 14). His adjustments for size and amenities are altogether unexplained. Moreover, Nelson is adjusting the *subject units* (Spruce, Maple, Walnut), rather than adjusting comparable rents to determine a market rent for the subject. This is atypical methodology. Likewise, Nelson’s expense analysis and his capitalization rate were calculated utilizing apartment data. For the same reasons we choose not to rely on the capitalization rate determined by Nelson, we do not believe that apartments, which are self-accommodating, would provide reliable value conclusions for the subject property.

In Nelson’s opinion, the property is comparable to commercial apartments because “a significant portion of the subject property is effectively housing, which suggests a comparison to apartments.” (Exhibit 1. Page 12). He also states, however, “the subject has over 40% common area” that is used for the activity of the residents or as common space “used to deliver the primary services (meals, activities, medical services.)” (Exhibit 1, pp. 14-15). He asserts that he accommodates for the extensive common area of the subject compared by allocating a rent to the common area of the subject property.

We note that the majority of the units lack accommodations consistent with standard apartment units. The memory care units of the subject property do not have kitchens and would not be comparable to apartments. The other units of the subject property that are not devoted to memory care have only a partial kitchen that includes a "single-well sink, an under-counter refrigerator, and a microwave." (Exhibit 1, pp. 1-E, 7). The units do not have ovens, stoves, or laundry facilities, and lack full-sized refrigerators.

Nelson asserts because the subject is a residential property, he believes the best "pure comparison" are apartment buildings. Nevertheless, he notes the subject property is "specially designed as a senior living community, and it could not easily be converted to another use." (Exhibit 1 p. 9). Further, he testified he does not see the subject improvements having any other use besides senior housing or maybe another congregate care use. Yet, he repeatedly compares the subject property to a different use (commercial apartments) and asserts he was seeking the "real estate component" of the subject property. However, in doing so, he does not appear to consider the use of the subject improvements as of January 1, 2013.

Deborah Davis of Strategic Tax Services, Inc. also testified for Eby. Ultimately, she did not provide an opinion of value for the subject property of January 1, 2013, and therefore we give her testimony no consideration.

Deputy Assessor Tom McManus testified for the Board of Review. McManus personally inspected and helped with the valuation of the subject property and other similar properties in Davenport. McManus provided testimony regarding the cost valuation of $2,350,000. (Exhibit C). He explained that the Iowa Department of Revenue Cost Manual was used in the cost analysis. He points out that the appraiser who valued the subject found the improvements to be in normal condition, but believed the functional utility was fair. This resulted in depreciation being applied in the cost analysis.

Eby questioned McManus regarding the subject property's grade factor. McManus explained the appraiser determines the grade factor, which in this case equals a 41% positive influence. He also explained the grade reflects the quality of construction and materials used in the property. McManus testified that if you look at the subject property's record card, it has a high number of "cuts and corners" and, thus, is a higher quality property.

The Board of Review submitted an appraisal by Ranney Ramsey of Nelsen Appraisal Associates, Inc., Urbandale, Iowa. Ramsey developed all three approaches to value (cost, income, and sales comparison). (Exhibit D). The following table shows his conclusions for each approach.

Cost Approach	$2,500,000
Sales Comparison Approach	$2,600,000
Income Approach	$2,500,000

Ramsey reconciled the three approaches to a conclusion of $2,600,000, which he then deducted $275,000 in personal property to reach his final opinion of $2,325,000 as of January 1, 2013.

Ramsey agrees with Nelson that the current use of the subject property as an assisted living center is unlikely to change; although, because of the smaller unit sizes, it may eventually evolve into an assisted living center devoted entirely to memory-care. Because of the property's design, he believes the best comparisons would be assisted living facilities.

Ramsey determined a site value for the subject property of $310,000. In arriving at this opinion, he analyzed and compared seven vacant land sales, which were purchased with the intent of developing a senior housing project. Eby was critical of a land sale considered by Ramsey, located at 6701 Jersey Ridge Road, Davenport, Iowa. Ramsey identified this sale has having 20 acres, whereas Eby asserts the actual sale was for 40 acres, which would reduce the sales price per square foot. Ramsey agreed it was reasonable that Eby's assertions were correct, but that it would not change his opinion of land value, which he determined to be $3.00 per-square-foot. He explained that he considered all of his land sales. His land sales ranged from $1.23 to $5.46 per-square-foot.

Ramsey also explained the cost approach involved direct and indirect costs, entrepreneurial incentive, soft costs, and deprecation. He relied on Marshall Valuation Services, and he used the section of the manual for a multiple residence elderly assisted living. He acknowledged an oversight in the report resulted in 0% physical depreciation. He stated the deprecation should be expressed by the effective age over the economic life, 8/55 or 14.5%. Correcting this error would result in a reduction of roughly $370,000; however, increasing the physical depreciation will result in a decrease in the economic obsolescence. Essentially, in his opinion, the error is offsetting and he would reach the same conclusion in the cost approach.

Ramsey included six sales of assisted living centers in the Midwest for his sales comparison analysis. Eby was critical of some of the sales. Sale 1 is located at 4817 Oak Hill Road, Rochester, Illinois, and Ramsey reported the sale price was $5,200,000 in June 2013. Eby asserts the property's assessment was $2,657,646 but it did not provide the year of the assessment. In Eby's opinion the lower assessment demonstrates the Assessor "appears to be disregarding" the sale. (Exhibit 4). We do not reach this same conclusion and find the assessment irrelevant.

Ramsey selected Sale 2, located at 1611 Fairway Drive, Augusta, Kansas, because it is similar in size and use to the subject property and was a recent transaction. The property sold for $2,200,000 on June 4, 2013. Eby asserts this was a skilled nursing facility; however, Ramsey stated it is an assisted living project, and he verified that during his research.

Sale 3 was a multi-parcel sale located at 22550 South Franklin Street, Spring Hills, Kansas, and 5419 West 145th Street, Leawood, Kansas. Ramsey used the facility located in Spring Hills, a 48-unit assisted living center with a sales price of $7,000,000, in his analysis. He relied on this property because he was able to confirm its purchase price with two separate sources. He was unable to verify the sister-sale in Leawood and, therefore, did not include it in his overall analysis. Eby was critical of this sale because it was a multi-parcel purchase. Ultimately, Ramsey gave this sale minimal consideration because it was subject to a lease with a reported 100% occupancy, resulting in a "high indication of value even though its adjusted sales price per square foot was relatively low." (Exhibit D, p. 79).

Sale 4 is located at 20800 West Maple Road, Elkhorn, Nebraska. It was a similar-style assisted living facility with 64 units; and Ramsey explained he had good information on the purchase and financing of this property. Eby criticized this sale asserting there was intangible business value of $1,841,000, and $100,000 in personal property. Ramsey explained he valued the subject property in its current use. Ramsey reduced any personal property or intangibles that would apply to the subject property; and there was nothing that he was aware of which would constitute intangible business value of that magnitude.

Ramsey considered Sale 5, at 209 Jefferson East, Winterset, Iowa, because of its location and similarities to the subject property. In addition, this particular community had experienced a slow decline for several years, like the subject property. Eby was critical of this property, asserting the purchaser owned other nursing homes in the community and converted this sale from private condominiums for seniors into an assisted living center. Despite this criticism, Ramsey considered this a reasonable comparable.

Ramsey testified that he included Sale 6, located at 2418 Kent Avenue, Ames, Iowa, because it was an "exact duplicate of the subject property." He explained it sold in 2008 and was sale-leaseback; therefore, it sets the high end of the value. He gave it no weight and simply included it for informative purposes.

After Ramsey adjusted the properties for differences, their sales prices ranged from $93 to $147 per-square-foot. (Exhibit D, p. 78). After reconciling the sales, Ramsey determined an opinion of value for the subject property of $110 per-square-foot, or $2,600,000 rounded, by the sales comparison approach.

Nelson criticized what he termed Ramsey's "top-down" approach to valuation and claimed that it should not be used. According to Ramsey, this is the standard methodology because the market typically trades these interests. Ramsey explained that buyers and sellers have a difficult time, and rarely a reason, to divide what they call the "business value" from the real estate. In his opinion, the buyers and sellers often misconstrue the meaning of "business value," which he identifies as how the property is used by either the tenants or the investor; essentially its current use. He further notes that these participants consider the real estate as being nothing but the vacant "bricks and mortar" and the land. From an appraisal standpoint, however, the property and its use must be considered. Ramsey noted that Jim Tellington, an appraiser from St. Louis with an MAI designation from the Appraisal Institute, has authored textbooks on this issue. The textbook and one-day seminar deals with valuation issues on health-care properties. In Tellington's opinion, unless there are insufficient comparable properties for analysis, the top-down method should be used. Ramsey believes there were sufficient comparable properties to determine the fair market value of the subject property.

Eby questioned Ramsey, asking where, in any of his approaches, he deducted what Eby identifies as intangible values, being the services provided to the tenants. Ramsey testified that he does not believe the services Eby references are intangible items. He asserts the services are "part and parcel," and incidental to the use of the real estate in leasing the space to the tenants that this building was designed to cater to and serve. He testified the management of the subject property is set up to accommodate those tenants. Ramsey explained it is like a hotel that operates on temporary residency, and offers a restaurant or food to its visitors, whereas an apartment does not. The properties offer different services based on their use.

Lastly, Ramsey developed the income approach. He relied on the rent roll, a three-year operating history of the subject property, and a survey of specific assisted living facilities in the community. He developed a forecast of the expected revenue based on the number of units, the market rate for each unit, and allowed for vacancy and credit loss. He notes this property's 30% vacancy and credit loss was substantial. He then deducted operating expenses to arrive at an estimate of net operating income (NOI) of $318,224. Eby questioned Ramsey about the three year operating history reporting the 2010, 2011, and 2012 NOI of just over $480,000, roughly $102,000, and just over $220,000, respectively. (Exhibit D, p. 81). Ramsey explained the subject property's poor occupancy and the difficulty it has had in competing in the market resulted in the large fluctuations. Finally, Ramsey used investor surveys that specialize in senior housing, a mortgage equity analysis, and market extraction and determined a capitalization rate from the market of 9.0%, with an effective tax rate of 3.89% for a total capitalization rate of 12.89%. He then capitalized the NOI to determine value of $2,500,000 by the income approach.

Ramsey reconciled the values from the three approaches. He explained there was a very narrow range, but ultimately he gave most weight to the sales comparison approach because Iowa law prefers it. He concluded an opinion of $2,600,000 for the subject property in its current use and then deducted $275,000 in personal property resulting in a final value of $2,325,000.

Conclusion of Law

The Appeal Board has jurisdiction of this matter under Iowa Code sections 421.1A and 441.37A. This Board is an agency and the provisions of the Administrative Procedure Act apply. Iowa Code § 17A.2(1). This appeal is a contested case. § 441.37A(1)(b). The Appeal Board determines anew all questions arising before the Board of Review, but considers only those grounds presented to or considered by the Board of Review. §§ 441.37A(3)(a); 441.37A(1)(b). New or additional evidence may be introduced. *Id*. The Appeal Board considers the record as a whole and all of the evidence regardless of who introduced it. § 441.37A(3)(a); *see also Hy-vee, Inc. v. Employment Appeal Bd.*, 710 N.W.2d 1, 3 (Iowa 2005). There is no presumption the assessed value is correct. § 441.37A(3)(a). However, the taxpayer has the burden of proof. § 441.21(3). This burden may be shifted; but even if it is not, the taxpayer may still prevail based on a preponderance of the evidence. *Id.*; *Richards v. Hardin County Bd. of Review*, 393 N.W.2d 148, 151 (Iowa 1986).

In Iowa, property is to be valued at its actual value. Iowa Code § 441.21(1)(a). Actual value is the property's fair and reasonable market value. § 441.21(1)(b). Market value essentially is defined as the value established in an arm's-length sale of the property. *Id*. Sale prices of the property or comparable properties in normal transactions are to be considered in arriving at market value. *Id*. If sales are not available to determine market value then "other factors," such as income and/or cost, may be considered. § 441.21(2). The property's assessed value shall be one hundred percent of its actual value. § 441.21(1)(a).

In an appeal alleging the property is assessed for more than the value authorized by law under section 441.37(1)(a)(2), the taxpayer must show: 1) the assessment is excessive and 2) the subject property's correct value. *Boekeloo v. Bd. of Review of the City of Clinton*, 529 N.W.2d 275, 277 (Iowa 1995). The sales-comparison method is the preferred method for valuing property under Iowa law. *Compiano*, 771 N.W.2d at 398; *Soifer v. Floyd Cnty. Bd. of Review*, 759 N.W.2d 775, 779 (Iowa 2009); *Heritage Cablevision v. Bd. of Review of Mason City*, 457 N.W.2d 594, 597 (Iowa 1990). "[A]lternative methods to the comparable sales approach to valuation of property cannot be used when *adequate* evidence of comparable sales is available to *readily* establish market value by that method." *Compiano*, 771 N.W.2d at 398 (emphasis added). "Thus, a witness must first establish that evidence of comparable sales was not available to establish market value under the comparable-sales approach before the other approaches to valuation become competent evidence in a tax assessment proceeding." *Id*. (citing *Soifer*, 759 N.W.2d, at 782); *Carlon Co. v. Bd. of Review of Clinton*, 572 N.W.2d 146, 150

(Iowa 1997). Before relying on the income approach or other factors, a party or witness must first establish that comparable sales are not available to value the property. *Compiano*, 771 N.W.2d at 397-99; § 441.21(2).

Assessors are permitted to consider the use of property as a going concern in its valuation. *Riso v. Pottawattamie Bd. of Review*, 362 N.W.2d 513, 517 (Iowa 1985). "[A]ssessed property is valued based on its present use, including any functioning commercial enterprise on the property." *Soifer v. Floyd Cnty. Bd. of Review*, 759 N.W.2d 775, 788 (Iowa 2009). When an assessor values property as a going concern, "he is merely following the rule that he must consider conditions as they are." *Id*. (quoting *Maytag Co. v. Partridge*, 210 N.W.2d 584, 591 (Iowa 1973)).

Eby submitted an appraisal by David Mark Nelson. Nelson did not develop the sales comparison approaching because in his opinion "few sales of existing facilities within the regional market are available for comparison." (Exhibit 1, p 12). It is his belief that it is too difficult to confirm sales that have occurred and that proper real estate allocations between real property, personal property, and business value are rarely made. We question this rationale as the record suggests sales data of assisted living centers is available and can be analyzed. We are not convinced that comparable sales were not available to readily establish the subject property's market value. *Compiano*, 771 N.W.2d at 398. Additionally, in our view the fact that such allocations are rarely made suggests that the underlying assumption of Nelson's valuation methodology – namely his attempt to extract the "real estate component" – is flawed.

Nelson further asserts that because the subject property is "effectively housing," it is properly compared to apartments. Although he did not compare the subject property, an assisted living center, directly to apartments in a sales comparison analysis, he used data from apartment complexes to determine rents, expense ratios, and capitalization rates for his income analysis. Further, in the cost approach, he compared the subject's commercial kitchen and dining areas to restaurants and concluded it was an over-improvement for the subject property.

We disagree with Nelson's comparison and subsequent analysis. We do not find apartments to be comparable to the subject property. Although, like apartments, the subject property is residential in nature, the two differ significantly in the manner in which the respective inhabitants reside. An assisted living center is necessarily more communal than the commercial apartment complexes Nelson used to determine rents, expense ratios, and capitalization rates. The property as a whole has a significant amount of common area that commercial apartments would not have. This additional common area is necessary because the individual units lack many standard amenities of a traditional apartment complex. Because he relies heavily on commercial apartment buildings, he significantly discounts the common areas and service areas, such as the full service kitchen, dining, and laundry areas, that are inherent in the operation and current use of the subject property. Absent their existence, the residents could not be adequately fed or clothed. Essentially, we find Nelson valued the sticks and bricks of the improvements and did not consider the present use, going concern value of the property as of January 1, 2013. *Soifer*, 759 N.W.2d at 788; *Riso,* 362 N.W.2d at 517; *Maytag Co.,* 210 N.W.2d at 591. Therefore, we give his conclusion no consideration.

The Board of Review submitted an appraisal by Ranney Ramsey. Ramsey developed all three approaches to value giving most reliance to the sales comparison approach to value. He included six sales, but did not rely on Sale #6 because it was 100% leased at the time of sale. In Ramsey's opinion, the subject property should be compared to other assisted living facilities as this best captures the current use of the real estate value. We agree. Ramsey determined a 2013 fair market value of $2,325,000. Thus, the record shows the subject property is assessed for more than authorized by law.

THE APPEAL BOARD ORDERS the assessment of the property located at 4040 E 55th Street, Davenport, Iowa, is modified to a total value of $2,325,000, as of January 1, 2013. The Secretary of the Property Assessment Appeal Board shall mail a copy of this Order to the Scott County Auditor and all tax records, assessment books and other records pertaining to the assessments referenced herein on the subject parcels shall be corrected accordingly.

Dated this 4th day of August, 2014.

Karen Oberman

Karen Oberman, Presiding Officer

Stewart Iverson

Stewart Iverson, Board Chair

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